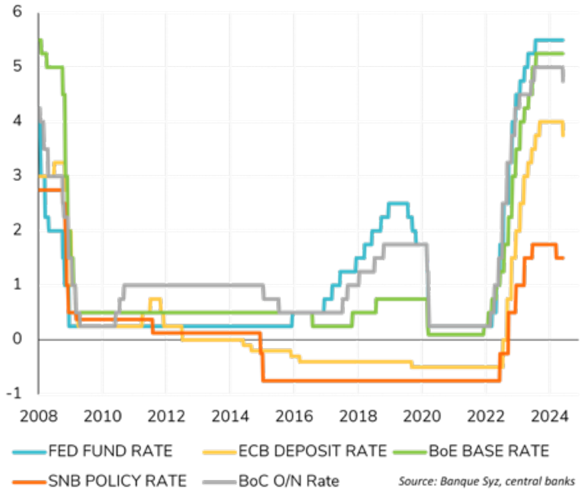
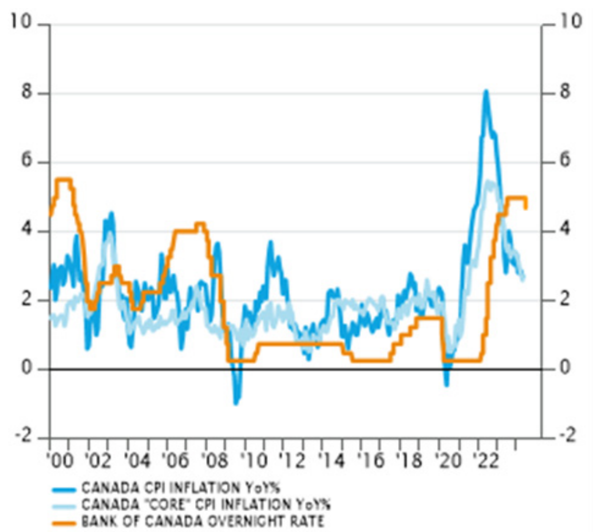
The beginning of the global rate cut cycle

After months of speculations, this week could mark the start of the long-awaited global rate cut cycle across developed economies. Rate cuts by the ECB and the Bank of Canada cement the beginning of the monetary policy normalisation process across large economic areas, while signs of easing in US labour market tensions point to lower inflationary pressures for the second half of the year. As price dynamics gradually normalise across key areas, central banks will have to recalibrate their monetary policies, as they have become overly restrictive for economies growing just at, or even below, their trend rate.



The Swiss National Bank was a precursor in March, being the first G10 central bank to cut its key rate from the highs reached to fight the post-pandemic inflationary wave. The Swedish Riksbank had followed suit in May, but this week's decisions by the European Central Bank and the Bank of Canada suggest that rate cuts are becoming a global trend rather than country-specific adjustments.

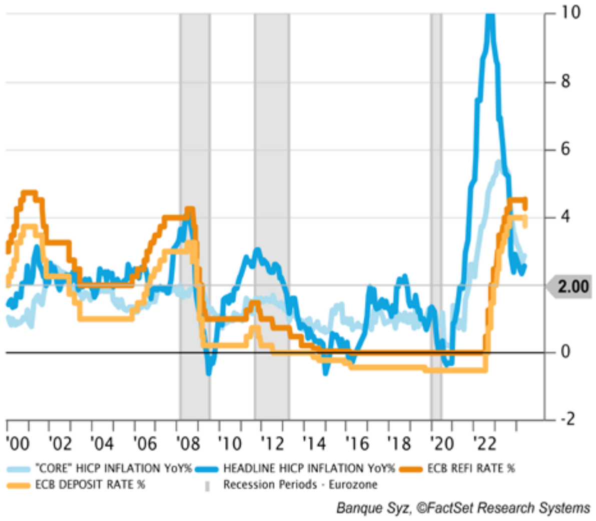
On June 5th, the Bank of Canada reduced its target overnight rate by 25bp, from 5.00% to 4.75%, a first move away from the two-decade high at which the rate had been set since last summer. With a combination of slowing employment growth and moderating wage pressures, inflation declining to a 3-year low in April and continued evidence that underlying inflation is easing, "the Governing Council agreed that monetary policy no longer needs to be as restrictive." Unless surprising and unexpected developments in the coming months, the Bank of Canada should continue to loosen its monetary policy in the coming meetings, possibly as soon as its next committee scheduled on July 24th. Governor Tiff Macklem refrained from committing or giving hints in that direction during the press conference, but he didn't rule out the possibility neither.



Today, the ECB also announced a 25bp cut in its key rates, lowering the Refi rate from 4.50% to 4.25% and the Deposit rate from an all-time high of 4.00% to 3.75%. Beyond this much-expected cut, the message conveyed by Ms Lagarde was cautious and aimed at signalling that, in a context of improving economic growth and lingering upward pressures on wages, the ECB will wait before contemplating additional rate cuts in the coming months.

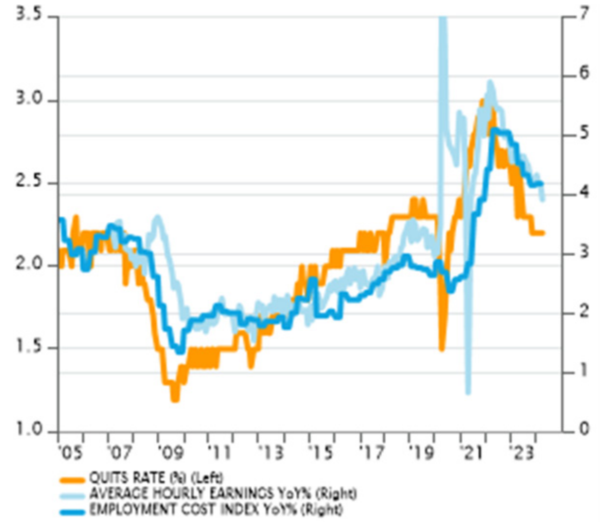
Supporting this view, the ECB revised its GDP and inflation forecasts for 2024. It now expects +0.9% for the GDP this year (vs +0.6% in March) and +2.5% for the inflation rate (+2.3% previously), still above its 2% target.

However, as inflation is expected to continue slowing down in the following year, the trend appears set for a gradual decline in ECB key interest rates. The timing of the coming rate cuts is however uncertain and will be dictated by developments in wage growth and economic activity.



On the other side of the Atlantic, the US Federal Reserve will hold its next monetary policy meeting on June 12th and shouldn't join the rate cut party yet. Indeed, the first months of the year have seen inflation unexpectedly picking up in the US, in a context of surprisingly resilient economic activity and still tight labour market. This has led the central bank to delay its monetary policy easing plans, with financial markets at some point even questioning whether the Fed will cut rate at all in 2024.

However, inflation data released in May have reversed and eased concerns around persisting inflationary pressures. This week, important data about the US employment market have clearly pointed to a normalisation of the tightness that had been fuelling strong wage growth and been a concern for the Fed. The number of Job openings fell to its lowest level since the end of the pandemic, and the Quits rate, the share of workers leaving voluntarily their job (presumably as they have found another better, higher paid one) is now back below its pre-pandemic level. Less tension and turnover on the labour market will likely result in slowing wage growth during the second half of the year. It is certainly a highly welcome development for the Fed, that has been concerned by the inflationary risk of this very tight labour market.



Following those developments, the likelihood of a rate cut in September has increased and could become a reality if the recent slowdown in inflation and growth dynamics extends throughout the summer. However, unless the deterioration in economic conditions is really pronounced, cutting rates just a few weeks ahead of the November 5th Presidential election could be seen as ill-timed. In that case, the Fed's meeting held on November 7th (two day after the elections) could become the preferred choice of Mr Powell and his peers to start cutting rates in the US as well. Here too, it is basically only a question of timing, with inflation and growth data being the main drivers, and political events possibly tilting the decision.

In the UK, the General Elections will quickly be concluded, allowing the Bank of England to move forward, as the elections are scheduled for less than a month from now. (July 4th). Since activity and inflation data have generally been exceeding expectations recently, there is no strong pressure on the BoE to cut rates hastily. However, given the fact that monetary policy has also become restrictive in the UK, with the slowdown in inflation, some recalibration and at least one, or two rate cuts might be warranted in the second half of the year to avoid exerting undue pressure on economic activity.

After the unprecedented rise in global interest rates two years ago, the time has now come to gradually ease on the brake of monetary policy. Inflation is not yet at levels targeted by central banks in many economies, but the trend is clearly slowing down as excesses and imbalances of the post pandemic-era are fading away. If there is no recession, central banks will proceed cautiously in lowering their key rates, looking for confirmations that underlying inflationary pressures are really cooling down. The length of this process may be different from one economy to another, and rate cuts will possibly be faster for some central banks, and slower for others. But the trend is there, and this week might be remembered as the week when it all begun.

For further information

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